cost-of-service regulation of cable rates is imminent, BellSouth recommends that the Commission adopt an interim rate of return benchmark for cost-of-service filings while it conducts additional proceedings to finalize rate of return methodologies that are appropriate for the cable industry.

BellSouth concurs with the Commission's conclusion that it is not practical to establish separate rates of return for each franchise area or for each cable company.[36] The rate of return adopted by the Commission will not apply to all cable operators, only those that attempt to charge prices in excess of the benchmark/price cap levels. In fact, the rate of return will not even apply to all of the services offered by cable operators electing the cost-of-service option, since cost-of-service regulation applies only to regulated cable services, not to premium services and non-cable services. As discussed earlier in these comments, the cost-of-service option is really a fall back to provide cable operators not subject to effective competition an opportunity to charge rates that are necessary to attract capital and remain in operation.

BellSouth concurs with the Commission's conclusion that the Commission must utilize a surrogate, rather than a direct market analysis, to establish a rate of return for

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[36]NPRM at para. 46.

regulated cable services.[37] First, to BellSouth's knowledge there are no publicly traded "pure play" cable operators that provide only regulated cable services. In the absence of an analysis of the relative risks of regulated cable services, premium services and non-cable services, any direct market analysis of cable providers would, at best, provide only a loose surrogate for the risks inherent in the provision of regulated cable services.

Regulated cable services, by definition, remain monopoly services, since the cost-of-service analysis is applicable only to the rates of cable operators not subject to effective competition. Thus, it can be assumed that the risk associated with the provision of regulated cable services is something less than that associated with the S&P 400 as a whole. Consequently, the Commission could use the average return of companies making up the lower range of the S&P 400 to provide a surrogate to develop the equity component of a rate of return benchmark for regulated cable services.[38]

There is little or no evidence in the record regarding the capital structure and cost of debt of the cable industry. In the absence of such information, the

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[37]NPRM at para. 48.

[38]The Commission used a similar approach to approximate the risk associated with the provision of the interstate access services by LECs, although the Commission erred when it limited the range of firms representative of the LECs to only the lowest quartile of the S&P 400.

Commission cannot conduct a traditional rate of return analysis at this stage of this proceeding. Therefore, BellSouth recommends that the Commission adopt an interim rate of return based on a surrogate until the data necessary to conduct a traditional rate of return review of the cable industry is placed on the record and can be reviewed by interested parties.

BellSouth recommends that the Commission require cable operators to submit relevant information regarding their actual capital structure and embedded cost of debt for use in a rate of return prescription for regulated cable services. BellSouth recommends the use of historical test year data, adjusted for known and measurable changes, and the embedded cost of debt to establish the prescribed rate of return.[39] By using historical data rather than forecasts, the administrative burden on both the Commission and the cable operators would be minimized. The suggestion in the NPRM that the Commission incorporate an investment cycle approach to measuring the rate of return appears to be unduly complicated, and should be discarded.[40]

C. Cost Accounting and Cost Allocation Requirements

1. Cost Accounting Requirements

As the Commission has already recognized in the Report and Order, cost accounting and cost allocation requirements

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[39]NPRM at para. 55.

[40]NPRM at para. 56.

are essential to meaningful cost-of-service regulation. The Commission has already required cable operators to follow GAAP accounting and to allocate costs to cost categories necessary for cost-of-service showings.[41] The NPRM asks for comment on whether new or supplemental cost accounting or cost allocation rules are required.[42]

BellSouth recommends that the Commission expand the scope of Section 76.924(a) of the Rules. As written, Section 76.924(a) is limited to:

> . . . cable operators for which the basic service tier is regulated by local franchising authorities or the Commission, or, with respect to a cable programming services tier, for which a complaint has been filed with the Commission.

It is impossible to predict which cable operators may file cost-of-service showings or which cable operators may be the subject of future complaints. If the basic financial records of a cable operator are not maintained in accordance with GAAP, and the cost allocation requirements contained in Section 76.924(e)-(h) are not followed when entries are made on the books of the cable operators, it may be impossible to reconstruct the data necessary to resolve a cost-of-service showing or a complaint. BellSouth therefore recommends that the scope of Section 76.924 of the Rules be expanded to include all cable operators.

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[41]NPRM at para. 57; 47 C.F.R. § 76.924.

[42]NPRM at paras. 58-59.

If cable cost-of-service and complaint proceedings are to be resolved efficiently, the Commission must adopt uniform accounting requirements applicable to all cable operators. The supplemental financial and cost accounting requirements included in Appendix A to the NPRM are extremely basic. The proposed expense accounts in particular are highly aggregated and represent organizations rather than functions. The development of cost by function therefore depends on the implementation of the cost allocation requirements of Section 76.924 of the Rules. It is highly unlikely that these general principles will be implemented in a uniform fashion, and the task of auditing each carrier's application of the rules will place a severe burden on regulators and customers. Therefore, BellSouth recommends that the Commission consider adopting a uniform system of accounts that records data by function, similar to the accounting system for telecommunications carriers contained in Part 32 of the Rules.[43] Such an accounting system is essential if reported financial results are to exhibit stability and consistency.[44] If the Commission is concerned that small cable operators will be unduly burdened by such a requirement, it can establish the equivalent of Class A and Class B companies, and require the smaller cable

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[43]NPRM at para. 58.

[44]47 C.F.R. § 32.1.

operators to maintain records and record transactions at the summary account level only.[45]

2. Cost Allocation Requirements

Appendix A to the NPRM contains six broad cost categories.[46] These categories complement the cost assignment and allocation requirements contained in Section 76.924(e) of the Rules. BellSouth believes that these categories represent the minimum level of disaggregation needed to effectively conduct cost-of-service analyses. The cost accounting and allocation requirements adopted in this proceeding should be extended to external costs.[47]

The NPRM proposes to establish affiliate transaction rules concerning transactions between the regulated and nonregulated portions of cable systems.[48] The NPRM proposes to define an affiliate as an entity that owns five percent or more of the cable operator. This proposed definition is not reasonable. An affiliated relationship exists when an entity is controlled by, or is under common control with, another entity. BellSouth knows of no regulatory or accounting standard that suggests that a five percent ownership interest gives the owning entity control.

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[45] See 47 C.F.R. § 32.11.

[46] The version of Appendix A attached to the NPRM inadvertently omitted category (d) Equipment Basket. From the context it is clear that such a basket was intended.

[47] NPRM at para. 86.

[48] NPRM at para. 67.

Moreover, a five percent ownership in two different entities by a third party does not result in the two entities being under common control of the third party. Accordingly, GAAP would not permit these entities to record or report transactions with each other as affiliated transactions. The Commission used the GAAP definition of affiliation in its Part 32 rules applicable to telecommunications carriers. BellSouth recommends that the Commission use the same definition for cable operators.

BellSouth concurs that affiliate transaction rules are necessary if regulated cable rates are to be evaluated on a cost-of-service basis, and to resolve complaints. Such requirements should encompass transactions with affiliates concerning programming.[49] Where an affiliate of the cable operator produces programming that is sold to the cable operator, the affiliate transaction rules should apply.

BellSouth believes that cable operators should be able to record transactions with affiliates on their books at the market price charged by the affiliate, provided the affiliate has sufficient and substantial third party transactions to establish a credible arm's length transaction price.[50] This is similar to the requirement imposed on telecommunications carriers. If the standard for the application of the market price is not met, the

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[49]NPRM at footnote 70.

[50]NPRM at para. 68.

transaction should be recorded at the affiliate's fully distributed cost.

The NPRM also seeks comment on whether the Commission should adopt asymmetrical affiliate transaction rules like those applicable to asset transfers between telecommunications carriers and their affiliates.[51] As set forth in the NPRM, the proposed asymmetrical affiliate transaction rules would appear to apply to both asset transfers and the provision of services between affiliates. Such a requirement would be unduly burdensome to both cable operators and regulators. Each transaction would have to be evaluated both on a fair market value and net book cost basis to apply the proposed rule. Such a requirement is extremely burdensome when applied to asset transfers, which normally are of small value and occur infrequently. To expand the scope of such a requirement to include the provision of services would strongly discourage such transactions. This would deprive cable subscribers of potential scale and scope economies that can be realized through affiliate transactions.[52] Accordingly, asymmetrical rules should not be required for asset transfers between regulated cable operators and nonregulated affiliates. Instead, the Commission should adopt net book cost as the value at which assets purchased from or sold to affiliates

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[51]NPRM at para. 69.

[52]<u>See</u> the examples cited in the NPRM at para. 62.

should be recorded on the books of account of regulated cable operators. The "net book cost" or "fully distributed cost" standard should apply to all affiliate transactions that do not meet the market price test discussed above.

IV. Streamlining Alternatives

A. General Alternatives

The NPRM seeks comment on alternatives that will streamline the establishment of cost based rates by cable operators.[53] BellSouth has offered several suggestions above that will streamline cable cost-of-service regulation, and which should be adopted for telecommunications carriers as well. Adoption of BellSouth's recommendations will result in a much simpler cost-of-service showing than that traditionally undertaken by regulators.

The NPRM seeks comment on whether the Commission should establish that initial rates for cable service will be considered reasonable if they are no higher than 1986 rates adjusted forward both by a general measure of inflation and a productivity offset.[54] In effect, this proposal would simply duplicate the primary benchmark/price cap formula, albeit with a different starting point.[55] Each cable

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[53]NPRM at para. 70.

[54]NPRM at para. 71.

[55]BellSouth supported this approach in its initial comments as a means of implementing price cap regulation of cable operators. Its use as a "streamlining" alternative, however, would tend to undercut the Commission's primary "benchmark and price cap" plan.

operator would be able to calculate its initial rates using both approaches and choose the one that provided the higher rate. This would appear to be contrary to Congressional intent.

The NPRM also seeks comment on an alternative that would permit cable operators to document key cost factors, financial characteristics, or other combination of factors that could be said to justify existing rates. Costs identified through this process would be permitted to be "added on" to the benchmark rates.[56] This approach presumes that the benchmark rates reflect some uniform set of cost characteristics. There is no factual basis for such a presumption. The benchmark rates were set based on prices charged in markets where effective competition was found to exist, not based on the cost characteristics of cable operators in such markets. There is no reason to assume that identified "add-on" costs are different from those already implicitly covered in the benchmark rate. At a minimum, the Commission would have to gather data on the cost characteristics of systems used to establish the benchmark rates and establish a "typical system" cost profile. "Add-ons" should be allowed only when the cable operator being analyzed has cost characteristics that vary significantly from the typical system cost profile.

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[56]NPRM at para. 72.

Even with this data, however, the Commission would have to consider whether the cost element that seems excessive was incurred to save costs elsewhere. For example, the NPRM cites comments by Continental Cablevision, Inc. comparing the employee/access line ratios in the telephone industry and the cable industry.[57] Such statistics demonstrate the substitutability of capital and labor. If a cable operator claimed an "add-on" for unusually high capital costs, the Commission would have to consider whether the high capital costs were incurred to reduce labor expense. If so, the capital cost "add on" should be reduced or eliminated to reflect the reduction in labor costs. The consideration of such issues inevitably drives the regulator back towards a full cost-of-service analysis. BellSouth doubts whether an "add on" approach, properly administered, would result in significant savings over a streamlined cost-of-service approach.

The same concern addressed above is applicable to the alternative set forth in paragraph 73 of the NPRM. This alternative would look only at one or a few areas of costs to determine if differences from the norm in these areas would justify above benchmark rates. Excess costs in one area may be offset by below average costs in another. An approach that would look at only some cost components in

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[57]NPRM at footnote 100.

isolation would miss these relationships, with the result that subscribers could be subjected to unjustified rates.

The NPRM also seeks comment on whether to use an approach similar to the "average schedule" approach available to small telecommunications carriers.[58] BellSouth has no objection to this approach if its application is limited to small systems as defined in 47 U.S.C. § 543(i). To implement such a system, sufficient cost-of-service data must be collected to develop a representative profile of small cable operators. This may require the creation of a quasi-regulatory entity such as NECA, with direct responsibility to the Commission and state regulators, to ensure that such cost data is collected in a reasonable, uniform and unbiased manner.

The NPRM next seeks comment on whether the Commission should establish an abbreviated cost-of-service showing for significant prospective capital expenditures used to improve the quality of service or to provide additional services.[59] BellSouth opposes this approach for several reasons.

First, the benchmark rates reflect the rapid capital recovery established by the cable industry in an unregulated environment. Therefore, the benchmark rates already provide the cash flows to cable operators to reinvest in system upgrades.

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[58]NPRM at para. 74.

[59]NPRM at para. 75.

Second, most system upgrades represent capital investments that should be, and will be, recovered through depreciation expenses. The use of the straight line, remaining life method of depreciation advocated herein by BellSouth will insure recovery of capital invested in system upgrades over the life of the investment. To permit cable operators to effectively surcharge their subscribers for system upgrades could result in excessive rates, contrary to Congressional intent. This inequity is avoided if the cost of system upgrades is recovered over the life of the investment through the depreciation process.

Third, competitive parity requires that depreciation expense be treated as "endogenous" under the cable price cap plan, as it is under the price cap plans applicable to the telecommunications industry.

Finally, such an approach would require that regulators examine not only the cost of system upgrades, but the benefit to the cable operator in the form of reduced expenses and additional revenue. These benefits would have to be quantified since they offset the real cost of the system upgrade. It is unclear that such an approach, if properly implemented, would provide significant administrative savings over a streamlined cost-of-service approach.

B. Small Systems

The NPRM seeks comment on ways to ease the regulatory burden on small systems to comply with the requirements of 47 U.S.C. § 543(i).[60] Of course, the Commission has already provided small system operators with an option that has few administrative burdens: the primary benchmark/price cap regulatory regime. Only if a small system seeks to charge rates higher than the benchmark will it be subject to the administrative burdens associated with a cost-of-service alternative. Nevertheless, there are additional measures that the Commission can take to ease the administrative burden on small systems that attempt to make a cost-of-service showing.

BellSouth suggests that small systems be subject to simplified accounting requirements similar to those applicable to Class B telephone companies. BellSouth also does not oppose the development of average costs for use by small systems in connection with cost-of-service showings. These proposals would significantly reduce the administrative burdens on small systems attempting cost-of-service showings without unduly compromising the customer protection intended by Congress in the Cable Act of 1992.

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[60] NPRM at paras. 76-78.

The suggestion that small systems be totally exempt from rate regulation[61] is contrary to Congressional intent. 47 U.S.C. § 543(i) expressly contemplates that small systems will remain subject to rate regulation.[62] Congress would hardly have enacted Section 543(i) if it intended that small systems be totally exempt from rate regulation.

C. Equipment

BellSouth concurs with the standards adopted for regulating equipment charges in the Report and Order. BellSouth would not object to the development of average equipment costs, and hence rates, for use in the streamlined regulation of small systems.[63] For larger systems, the burden of developing cost based equipment charges would appear to be minor. BellSouth concurs with the Commission's stated intent to gather data on equipment costs in connection with the cost studies required of cable operators.[64]

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[61]NPRM at para. 77.

[62]Section 543(i) provides: "Small system burdens. In developing and prescribing regulations pursuant to this section, the Commission shall design such regulations to reduce the administrative burden and cost of compliance for cable systems that have 1000 or fewer subscribers."

[63]NPRM at para, 79.

[64]NPRM at para. 80.

V. Productivity Offset

In the Report and Order, the Commission adopted a benchmark and price cap approach as the primary tool to control rates for regulated cable services.[65] The Commission mandated the use of the GNP-PI to measure inflation in the economy generally. The Commission recognized that it may be appropriate to adopt a "productivity offset" that would lower the permitted increase in cable rates.[66] The Commission deferred that question to this proceeding.[67]

As the NPRM recognizes[68], there is insufficient evidence in the record at this time to determine an appropriate productivity offset for the cable industry based on industry specific studies of the type used by the Commission in developing the price cap plan for the telecommunications industry. The Commission should undertake a productivity analysis of the cable industry like it did in the LEC price cap proceeding. In analyzing the appropriate productivity offset for the cable industry, the Commission should consider the fact that a larger proportion

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[65]NPRM at para. 81.

[66]The GNP-PI reflects the productivity achieved by the economy as a whole. A productivity offset is used where an industry can be expected to achieve productivity greater than that of the economy as a whole.

[67]NPRM at para. 82.

[68]NPRM at para. 85.

of total cable costs are treated as "exogenous" and are therefore passed through directly to customers than under the LEC price cap plan. For example, the LEC price cap plan generally treats tax increases as endogenous, whereas tax increases are treated as "exogenous" under the cable price cap plan.

The selection of an appropriate productivity offset for regulated cable services should recognize the convergence of cable television and telecommunications technologies and should provide a degree of regulatory parity as competition between the industries increases. Since both industries are deploying similar technologies to provide similar services, it would be rational to assume that similar productivity potential exists in both industries until such time as a cable industry specific analysis can be completed.

VI. Collection of Information

The NPRM seeks comment on the implementation of the information collection provisions of the Cable Act of 1992.[69] The NPRM solicits comment on two alternatives: an annual report by each cable operator or an annual survey of selected cable systems. The Commission tentatively favors the latter approach.

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[69]NPRM at para. 88. 47 U.S.C. § 543(g) provides: "The Commission shall, by regulation, require cable operators to file with the Commission or a franchise authority, as appropriate, within one year after October 5, 1992, and annually thereafter, such financial information as may be needed for purposes of administering and enforcing this section."

BellSouth recommends a combination approach. The data required to complete the proposed FCC Form 326, Schedules 2 and 3 (income statement and balance sheet) are basic financial information that each operator will undoubtedly maintain whether or not there is an information collection requirement.[70] Schedule 4 contains supplemental accounting information that is readily available. Requiring the filing of these schedules will impose little, if any, burden on cable operators.[71]

BellSouth recommends that the Commission utilize a survey approach to collect more extensive information, such as cost accounting and cost allocation data, that is necessary to provide adequate data to administer cost-of-service regulation. The survey approach should also be used to collect the data needed to determine an appropriate rate of return and an appropriate productivity offset, as discussed above. If the Commission elects to authorize the average schedule approach for small cable systems, sufficient data must be collected from small system

[70]BellSouth recommends that Schedule 2 be modified to report separately aggregate revenue derived from equipment sales, equipment rental and additional connections.

[71]A comparison of this basic information collection requirement with the extensive collection required of telephone carriers in the ARMIS reports demonstrates the inconsequential nature of the proposed information collection requirement for cable operators. The data required to complete proposed FCC Form 326 can be collected in a few hours by a cable operators.

operators, on a survey basis, to develop the average cost data that such an approach requires.

As an additional information collection requirement, the Commission should require cable companies to file informational tariffs for non-cable intrastate communications services that would be subject to regulation by the Commission or any State if offered by a common carrier.

The 1984 Cable Act provides:

> A state or the Commission may require the filing of informational tariffs for any intrastate communications service provided by a cable system, other than cable service, that would be subject to regulation by the Commission or any state if offered by a common carrier subject, in whole or in part, to subchapter two of this chapter. Such informational tariff shall specify the rates, terms, conditions for the provision of such service, including whether it is made available to all subscribers generally, and shall take effect on the date specified therein.[72]

The purpose of this provision is clearly explained in the legislative history of the 1984 Cable Act, which states:

> The Committee is concerned that the decision to regulate or to deregulate non-cable communications services be based upon sufficient information. State regulators, for example, may not know the rates, terms and conditions under which cable companies are offering an intrastate communications service unless the cable companies provide this information. Information tariffs would enable regulators to make a more informed judgment as to whether or how to regulate

[72] 47 U.S.C. § 541(d)(1).

> particular communications services provided by cable companies.[73]
>
> The Committee intends subsection (d) to reaffirm and clarify that regulatory officials have the authority to require cable companies to file informational tariffs to all communications services except cable systems [sic].[74]
>
> The Committee notes that the informational tariffs described in subsection (d), by specifying the rates, terms and conditions for the provisions of non-cable communications services, will assure effective monitoring of such services by regulatory officials. The intent of subsection (d) is purely informational, and the subsection creates no new or additional regulatory authority. For instance, subsection (d) does not require action by a regulatory body before a communications non-cable service may be offered, nor approval of the rates, terms and conditions of such service.[75]
>
> Refusal to file informational tariffs may result in appropriate sanctions under applicable law.[76]

While the statute speaks only in terms of "intrastate" communications services, the Commission clearly has sufficient authority under the Communications Act to impose a similar informational tariff filing requirement with regard to "interstate" services offered by a cable system.[77]

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[73] H.REP. No. 934, 98 Cong., 2d Sess. 19 (1984), reprinted in 1984 U.S. Code Cong. & Admin. News at 4697-98.

[74] Id.

[75] Id.

[76] Id.

[77] See Legislative History, 1984 U.S. Code Cong. & Admin. News at 4666. ("[The 1984 Cable Act] preserves the regulatory and jurisdictional status quo with respect to non-cable communications services.")

Requiring cable companies to file informational tariffs for both interstate and intrastate communication services will complement other cost-of-service accounting and regulatory safeguards in two important ways. One, it will assist the Commission and local franchising authorities in determining whether the costs of providing such non-cable services have been excluded from regulated cable rates as required by the 1992 Cable Act. Two, it would provide the Commission and state regulators with a simple and systematic means of obtaining the minimal information needed to begin the process of determining the appropriate degree of regulation, if any, of such services. Of course, a requirement to file informational tariffs would not excuse a cable company from the obligation of filing tariffs already required by statute, the Commission or state regulators with regard to particular services. For example, all interstate common carriers are required to file tariffs pursuant to the terms of the Communications Act.[78]

For the above reasons, the Commission should adopt an additional information collection requirement that cable companies file informational tariffs covering interstate and intrastate non-cable communications services with the

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[78] 47 U.S.C. § 203; See AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992); rehearing en banc denied, January 21, 1993, cert. denied MCI Telecommunications Corp v. AT&T, 125 L.Ed. 2d 709, 113 S. Ct. 3020, _________ U.S. _________ (1993).

respective federal or state commission having jurisdiction over those services when offered by a common carrier.

VII. *Conclusion*

The proposals contained in these comments will allow the Commission to meet the mandates of the Cable Act of 1992 in an administratively efficient manner with as little burden on cable operators as possible. BellSouth recommends their adoption.

Respectfully submitted,

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